

## **AGENDA**

### **COMMITTEE ON AUDIT**

**Meeting: 2:30 p.m., Tuesday, March 11, 2008**  
**Glenn S. Dumke Auditorium**

Raymond W. Holdsworth, Chair  
Kenneth Fong, Vice Chair  
Herbert L. Carter  
George G. Gowgani  
Melinda Guzman  
William Hauck  
Glen O. Toney

#### **Consent Items**

Approval of Minutes of Meeting of January 22, 2008

#### **Discussion Items**

1. Status Report on Current and Follow-up Internal Audit Assignments, *Information*
2. Single Audit Report of Federal Funds, *Information*

**MINUTES OF THE MEETING OF  
COMMITTEE ON AUDIT**

**Trustees of The California State University  
Office of the Chancellor  
Glenn S. Dumke Conference Center  
401 Golden Shore  
Long Beach, California**

**January 22, 2008**

**Members Present**

Raymond W. Holdsworth, Chair  
Kenneth Fong, Vice Chair  
Roberta Achtenberg, Chair of the Board  
Herbert L. Carter  
George G. Gowgani  
William Hauck  
Glen O. Toney

Chair Holdsworth called the meeting to order.

**Approval of Minutes**

The minutes of the meeting of November 13, 2007, were approved as submitted.

**Status Report on Current and Follow-up Internal Audit Assignments**

Mr. Larry Mandel, university auditor, presented the Status Report on Current and Follow-up Internal Audit Assignments, Agenda Item 1 of the January 22-23, 2008, Board of Trustees agenda.

Mr. Mandel stated that most of the audit plan for calendar year 2007 had been completed, with the remaining assignments in either the report-writing stage or incomplete stage where an exit conference or campus response was pending. He indicated that the campuses continue to make excellent progress in the timely completion of the recommendations. Mr. Mandel reported that two areas (FISMA, California Maritime Academy and Auxiliary Organizations, California State University, Dominguez Hills) had outstanding recommendations at nine months, but added that the office of the university auditor (OUA) was working with the campuses on the completion of those recommendations. He added that progress was also being made on the completion of recommendations pertaining to the six construction audits performed by KPMG for 2006/07 and anticipated completion prior to the next Committee meeting. In addition, he stated that for the 2007/08 fiscal year, six construction projects would be reviewed by KPMG, and noted that report writing was being completed for one campus and fieldwork was taking place at one campus.

Trustee Hauck inquired as to whether audits are done on a fiscal- or calendar-year basis.

Mr. Mandel explained that the internal audit assignments are done on a calendar-year basis but that the construction audits are done on a fiscal-year basis.

### **Assignment of Functions to be Reviewed by the Office of the University Auditor for Calendar Year 2008**

Mr. Mandel explained that each year at the January meeting of the Board of Trustees, the Committee on Audit selects three subject area audit assignments for the OUA and approves the audit plan for the year. He further explained that in addition to the subject area assignments, financial internal control (FISMA) reviews, auxiliary organization reviews, investigations, and oversight of the construction audits are planned for calendar year 2008.

Mr. Mandel stated that the results of the 2005 triennial risk assessment were used to assist in the selection of the audit assignments and noted that Audit Item 2, Attachment A, listed those areas of the highest risk based on the risk assessment. He further noted that six of the listed subject areas had not been audited in several years. In addition to the risk assessment, a meeting was held with the Executive Audit Committee (which is represented by four campus presidents and the executive vice chancellor/chief financial officer) to obtain executive insight into the selection process.

The following three subject areas were recommended for consideration for calendar year 2008: Information Security (which has never been reviewed), Student Records and Registration (last reviewed in 1999), and Public Safety (last reviewed in 2000).

Chair Holdsworth agreed with the selection of the subject areas, noting that Information Security is an area of great importance in this time of high technology, Student Records and Registration is also an area for particular attention due to the increase in the number of hacking incidents throughout the various universities nationwide, and Public Safety is an area that should be considered because it was last reviewed several years ago. He reminded the Trustees that reviews of Athletics Administration (including all Division I campuses) had been completed over a two-year period in the audit plans for 2006 and 2007 and therefore stated his belief that no further review was required on this topic.

Chair Holdsworth called for a motion to approve the Committee resolution (RAUD 01-08-01). A motion was then made and the resolution was passed unanimously to approve the audit plan for calendar year 2008.

## **Report of the Systemwide Audit in Accordance With Generally Accepted Accounting Principles Including the Report to Management**

Mr. Richard West, executive vice chancellor/chief financial officer, introduced the item by explaining that there are two ways the university is required to maintain its financial books: one is called the legal basis of accounting prescribed by the State of California and the other is the accrual basis of accounting in accordance with Generally Accepted Accounting Principles (GAAP). The legal basis of accounting is the method utilized in the revenue and expenditure reporting of state funds: state budget for capital purposes and state budget for operating purposes. He further explained that there are different rules and procedures for the use of each of these types of funds and noted that funds from a general fund operating budget cannot supplement a capital budget. However, at year-end, the legal-basis accounting records are converted to the GAAP accrual basis of accounting, and this is one place where these funds are reported together.

Mr. West then introduced Ms. Colleen Nickles, assistant vice chancellor, financial services, who presented the financial statements for the California State University (CSU) system for fiscal year ended June 30, 2007. She stated that the financial statements reflect the second year of the six-year higher education financing compact with the Governor, which included a 3-percent increase in state support and a fee buyout of \$54.4 million. She reported that in fiscal year 2006/07, the university's general fund increased by \$192.3 million. Regarding student enrollment in 2007, she noted that headcount had increased by 3.3 percent and full-time equivalent students had increased by 3.5 percent. She added that other than a slight decrease in 2005, enrollment had continued to increase from 2003 to 2007.

Ms. Nickles reminded the Trustees that it had been one year since the implementation of the Revenue Management Program (RMP), which allows for the deposit of student fee revenues into a CSU trust fund in a local bank (instead of the prior requirement of remitting these fees to the state) and provides more discretionary control over cash management.

Ms. Nickles reported that total revenues (operating, non-operating, and capital) for the university increased from \$5.3 billion in 2006 to \$5.5 billion in 2007, which is an increase of 4.4 percent. She further reported that total operating expenses also increased from \$4.8 billion in 2006 to \$5.1 billion in 2007, which is an increase of 5.3 percent. She explained that operating expenses are reported rather than total expenses because the university's non-operating expenses are quite minimal when compared to the operating expenses. She indicated that approximately \$320 million of the net difference between revenues and expenses went into capital assets and approximately \$80 million went into unrestricted net assets. She further reported that state appropriations, noncapital increased by 6.4 percent in 2007 and noted that there was also an increase in most of the other revenue categories (student tuition and fees; grants, contracts, and gifts; sales and services; investment income; and other). She added, however, that there was a slight decrease in state appropriations, capital (approximately \$100 million) because of the timing with capital projects. She discussed the comparison of operating expenses from 2006 to

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2007, noting that instruction increased by 6 percent and public service increased by 18 percent. She also noted that instruction and educational support account for more than 71 percent of the total operating expenses.

Ms. Nickles reported that net assets of the university increased from \$4.7 billion in 2006 to \$5.1 billion in 2007 (an increase of 7.4 percent), mainly because of an increase in invested and capital assets, net of accumulated depreciation and outstanding debt. She further reported that unrestricted net assets increased from \$882 million in 2006 to \$965 million in 2007 (an increase of 9.4 percent), largely as a result of growth in trust funds that are mostly made up of self-supporting activities, such as housing, parking, and continuing education revenue funds.

Trustee Hauck inquired as to why unrestricted net assets are called such, when they seem to be restricted.

Ms. Nickles stated that discussions have taken place with KPMG regarding the change in name for unrestricted net assets to eliminate the confusion throughout the university.

Trustee Hauck highly recommended the change in name for unrestricted net assets in order to eliminate the confusion and to be clear about what is actually being reported.

Chancellor Reed asked Mr. Chris Ray, managing partner, KPMG, how the definition of unrestricted net assets could be changed in light of the Governmental Accounting Standards Board (GASB) rules.

Mr. Ray responded that GASB is very specific as to what can be categorized as restricted net assets, investment and capital assets, and unrelated debt; everything else falls into unrestricted net assets. He stated that they would reevaluate to determine whether any changes have taken place to support moving certain assets to a restricted category.

Chancellor Reed asked whether Mr. Ray and his colleagues would have to raise those issues with GASB in order to get the definitions amended.

Mr. Ray responded affirmatively.

Trustee Hauck again stated his opinion that it does not make sense to categorize housing, parking, and other clearly restricted assets as unrestricted net assets. It is his presumption that GASB would like to be clear on these definitions and would like individuals to understand their financial statements. He strongly urged KPMG to review this and if necessary to initiate a request of GASB to change the definition.

Chair Holdsworth agreed with Trustee Hauck regarding initiating a request with GASB to change the definition of unrestricted net assets for clarification purposes.

Chair Holdsworth asked Mr. Ray as to whether a comparison of expenses for educational support could be provided in the future in relation to other similar universities.

Mr. Ray responded that the comparison could be completed and would probably show that the major difference would be the research and public service component, depending on the type of institution.

Chair Holdsworth commented on the overall positive results of the financial statement audit. He noted that with the issuance of the new auditing standard (SAS 112), there are more stringent reporting requirements by the campuses that all presidents and vice presidents of administration should be aware of for financial reporting.

Chair Holdsworth then asked Mr. Ray to discuss the CSU system financial statements for fiscal year ended June 30, 2007.

Mr. Ray stated that the systemwide report on the university's basic financial statements includes not only the 23 campuses and the chancellor's office, but also the 91 auxiliary organizations. He added that 90 of the 91 auxiliary organizations were audited by the 20 plus other accounting firms across the state of California. He further stated that the auditors' reports for each of the auxiliary organizations were accumulated and combined to issue an opinion of the financial statements for the CSU as a whole. Mr. Ray reported that KPMG issued an unqualified, clean opinion on the university's basic financial statements for fiscal year ended June 30, 2007, which indicates that the financial statements were fairly stated in all material respects in accordance with GAAP. He commented on the tremendous effort on behalf of the CSU system as a whole to meet the overall reporting deadlines, in light of other ongoing audits, the RMP implementation, etc.

Mr. Ray indicated that KPMG is required to provide information related to the audit of the university's basic financial statements, such as accounting practices and alternative treatments, audit adjustments and uncorrected and corrected misstatements, disagreements with management, etc. He reported that there were no significant difficulties encountered while dealing with management in performing the audit. He explained that in planning and performing the audit, KPMG considered the university's internal control over financial reporting as a basis for designing their auditing procedures for the purpose of expressing an opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the university's internal control over financial reporting. He also explained that KPMG's review also evaluated whether accounting policies and certain judgments and estimates by management (self-insurance claims for liability, allowances for accounts receivable, etc.) were appropriately disclosed in the financial statements.

Mr. Ray discussed two issues as highlighted in the Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*. He noted that a new auditing

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standard was issued (SAS 112) that requires specific reporting of more than inconsequential internal control deficiencies. He explained that the CSU system as a whole maintains its internal financial statements on the legal basis of accounting; at year-end, each of the campuses converts legal-basis accounting records to the accrual basis of accounting in accordance with GAAP, and he recognized this procedure as a monumental task. However, he stated that during the audit of the CSU system financial statements, KPMG encountered internal control issues related to the financial reporting process and the legal to GAAP conversion at several of the campuses. Mr. Ray explained that KPMG has an information technology team that reviewed the controls of the various information technology systems at each of the campuses. It was also noted that improvement was needed over specific controls related to user access at several of the campuses. He commented that both of the reported issues have either already been addressed by management or are in the process of being resolved. Overall, he stated that the audit went well and management was very proactive in ensuring that financial reporting was completed in a timely manner for the ease of the audit process.

Mr. Ray concluded by indicating that KPMG would be expanding the training regarding the legal to GAAP conversion because it is a significant effort and would assist with the issue of staff turnover on the campuses.

Chair Holdsworth acknowledged the two significant issues reported by KPMG and noted that the chancellor's office was addressing these issues. He reaffirmed to the campus presidents the importance of being aware of staff turnover issues at each of their respective campuses and ensuring that proper training is available to all accounting staff. He then thanked the chancellor, the campus presidents, and their staffs for this monumental task, especially considering that the CSU is the largest university system in the United States and in light of budget issues, staff turnover, more stringent rules and requirements, etc. Chair Holdsworth requested that in the future, the KPMG management letter be issued with more time to allow for review before the Committee meeting.

Chancellor Reed thanked Chair Holdsworth for his diligence as chair of the Committee on Audit, noting the numerous telephone calls and in-person meetings with chancellor's office management in order to follow the financial reporting process and to help ensure the completion of deadlines.

Chair Holdsworth reminded the Trustees that a chief audit executive from the Florida State System performed an examination of the current risks to the system versus the size of the audit staff currently in place. He stated that the final report had been received and that the recommendations were currently being reviewed and discussed with Chancellor Reed, Mr. West, and Mr. Mandel. He indicated that Chancellor Reed had also discussed the possible implementation of those recommendations with the campus presidents, depending on the outcome of the 2008/09 budget. He stated that an update on the recommendations would be presented at the March 2008 Board meeting. He added that in the future, internal audits would be conducted utilizing a risk-based assessment.

Board Chair Achtenberg congratulated Chancellor Reed and his staff for the successful accomplishment of the financial reporting process for the completion of the university's financial statements.

Chair Holdsworth adjourned the meeting.

## **COMMITTEE ON AUDIT**

### **Status Report on Current and Follow-up Internal Audit Assignments**

#### **Presentation By**

Larry Mandel  
University Auditor

#### **Summary**

This item includes both a status report on the 2008 audit plan and follow-up on past assignments. For the current year, assignments have been made to conduct reviews of FISMA (financial internal controls), Auxiliary Organizations, Information Security, Police Services, Student Records and Registration, and Construction. In addition, follow-up on past assignments (FISMA, Auxiliary Organizations, Contracts and Grants, Occupational Health and Safety, Athletics Administration and Special Investigations) is currently being conducted on approximately 25 prior campus/auxiliary reviews. Attachment A summarizes the reviews in tabular form. An up-to-date Attachment A will be distributed at the Committee meeting.

### **Status Report on Current and Follow-up Internal Audit Assignments**

At the January 2008 meeting of the Committee on Audit, an audit plan calling for the review of the following subject areas was approved: FISMA (financial internal controls), Auxiliary Organizations, Information Security, Police Services (formerly known as Public Safety), Student Records and Registration, and Construction.

#### *FISMA*

The initial audit plan indicated that approximately 130 staff weeks of activity (15 percent of the plan) would be devoted to auditing financial internal controls on 12 campuses. Report writing is being completed for one campus, while fieldwork is currently taking place at three campuses.

#### *Auxiliary Organizations*

The initial audit plan indicated that approximately 298 staff weeks of activity (35 percent of the plan) would be devoted to auditing internal compliance/internal control at 8 campuses/28 auxiliaries. Fieldwork is currently taking place at one campus/six auxiliaries.

#### *Information Security*

The initial audit plan indicated that approximately 97 staff weeks of activity (11 percent of the plan) would be devoted to a review of 10 campuses on solicitation activities and project approval; contract/grant budgeting and financial planning; cost accounting, allocation, and transfer processes; and award administration. The audit program for this subject is currently being field tested by the audit manager in charge of the project.

#### *Police Services*

The initial audit plan indicated that approximately 97 staff weeks of activity (11 percent of the plan) would be devoted to oversight of the campus injury and illness prevention program (IIPP), job and workplace conditions, employee health examinations and medical monitoring, health and safety training, work-related accidents, and programs for complying with federal and state occupational regulations. The audit program for this subject is currently being field tested by the audit manager in charge of the project.

#### *Student Records and Registration*

The initial audit plan indicated that approximately 97 staff weeks of activity (11 percent of the audit plan) would be devoted to a review of five to seven campuses to ensure proper administration/review of the general control environment for athletics and control activities undertaken to assure implementation of appropriate institutional systems, policies and procedures for financial oversight, and stewardship of athletics. The audit program for this subject is currently being field tested by the audit manager in charge of the project..

#### *Information Systems*

The initial audit plan indicated that approximately 45 staff weeks of activity (5 percent of the plan) would be devoted to review of systemwide projects such as: Disaster Recovery, Common Management Systems (CMS), and Web Security. In addition, support will be provided in the area of financial internal controls for both campus (FISMA) and auxiliary audits. Review and training are ongoing.

### *Follow-ups*

The audit plan indicated that approximately 23 staff weeks of activity (3 percent of the plan) would be devoted to follow-up on prior audit recommendations. The Office of the University Auditor is currently tracking approximately 25 prior audits (FISMA, Auxiliary Organizations, Contracts and Grants, Occupational Health and Safety, and Athletics Administration) to determine the appropriateness of the corrective action taken for each recommendation and whether additional action is required.

### *Consultations*

The Office of the University Auditor is periodically called upon to provide consultation to the campuses and/or to perform special audit requests made by the Chancellor. Eight staff weeks have been set aside for this purpose, representing approximately 1 percent of the audit plan.

### *Investigations*

The Office of the University Auditor is periodically called upon to provide investigative reviews which are often the result of alleged defalcations or conflicts of interest. In addition, whistleblower investigations are being performed on an ongoing basis, both by referral from the State Auditor, and directly from the chancellor's office. Forty-five staff weeks have been set aside for this purpose, representing approximately 5 percent of the audit plan.

### *Construction*

The audit plan indicated that approximately five staff weeks of activity (1 percent of the plan) would be devoted to coordination of construction auditing. For the 2006/07 fiscal year, six construction projects are being reviewed by KPMG with coordination from the Office of the University Auditor. Areas under review include construction bid process, change orders, project management services, contractor compliance, liquidated damages, and cost verification of major equipment and construction components. Five staff weeks have been set aside for this purpose, representing approximately 1 percent of the audit plan. Fieldwork is currently taking place on three projects.

**Status Report on Current and Follow-Up Internal Audit Assignments**  
(as of 2/25/2008)

	<b>2008 ASSIGNMENTS</b>					<b>FOLLOW-UP ON PAST/CURRENT ASSIGNMENTS</b>												
	FISMA	Aux Orgs	Info Security	Police Services	Student Records	Special Investigations		FISMA		Auxiliary Organizations			Contracts and Grants		Occ Health and Safety		Athletics Administration	
						*Recs	**Mo.	*Recs	**Mo.	•No.	*Recs	**Mo.	*Recs	**Mo.	*Recs	**Mo.	*Recs	**Mo.
BAK								12/12	-	3	22/22	-					0/13	4
CHI	FW									3	6/6	-	0/3	4				
CI								13/13		2	26/26	-						
DH								6/9	7	3	14/14	-						
EB	FW									4	40/40	-			7/9	7		
FRE		FW						7/7		6			7/9	6			15/15	-
FUL					FW			7/9	7	4	31/31	-	0/3	4			9/9	-
HUM								14/14	-	4	25/25	-					9/9	-
LB								13/13	-	3	19/19	-	0/2	3			11/14	7
LA	FW									4	7/11	3						
MA								14/16	11	2	14/14	-						
MB								8/8	-	2	17/17	-			0/9	3		
NOR	RW									5	30/30	-					12/12	-
POM			FW					10/10	-	3	18/24	7						
SAC								10/10	-	5	36/36	-	0/5	6			13/13	-
SB				FW				3/3	-	3	17/17	-						
SD								7/7	-	4	11/11	-					14/14	-
SF								11/11	-	4	32/32	-			1/6	4		
SJ								24/24	-	5	0/32	4					20/20	-
SLO								10/10	-	2	13/13	-						
SM								11/11	-	3	22/22	-						
SON						4/7	6	6/6	-	4	18/18	-	1/3	4				
STA								11/11	-	4	27/27	-						
CO								4/4	-	2	11/11	-						
SYS																		

FW = Field Work In Progress  
RW = Report Writing in Progress  
AI = Audit Incomplete (awaiting formal exit conference and/or campus response)  
AC = Audit Complete

\* The number of recommendations satisfactorily addressed followed by the number of recommendations in the original report.  
A "0" in a column is used as a place holder until such time as documentation is provided to the OUA evidencing that a recommendation has been satisfactorily addressed; significant progress may have been made prior to that time.  
\*\*The number of months recommendations have been outstanding (since the formal campus exit conference).  
• The number of auxiliary organizations reviewed.



**COMMITTEE ON AUDIT**

**Single Audit Report of Federal Funds**

**Presentation By**

Colleen Nickles  
Assistant Vice Chancellor  
Financial Services

**Summary**

The single audit report of federal funds and the related management letter for all campuses and the Chancellor's Office will be reviewed and discussed at the meeting. Representatives from KPMG, LLP, the external audit firm hired by the California State University to conduct the audit, will be available to respond to questions. A copy of the report was distributed with the agenda.